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TAGS: ECON EFIN TU
SUBJECT: NEW STUDIES HIGHLIGHT FRAGILE RECOVERY

¶1. Sensitive but Unclassified. Not for internet distribution.

¶2. (U) Summary: Two new national surveys of Turkish companies highlight signs of recovery from the devastating financial crisis of 2001. The studies, carried out separately by the Istanbul Chamber of Industry (ISO) and the Islamic-influenced Independent Industrialists' and Businessmen's Association (MUSIAD), show a modest recovery, led largely by growth in exports. ISO Chairman Tanil Kucuk stressed in announcing his organization's survey of the country's top 500 industrial companies that Turkey has benefited from booming exports but has much work to do to achieve "sustainable" economic growth. Though the study showed that Turkish industry returned to profitability in 2002, he warned that recent headline growth figures in GNP (at 7.8 percent for 2002 and 8.1 percent in this year's first quarter) exaggerate the economy's strength and are "too good to be true." End Summary.

Turkey's Industrial 500

¶3. (U) Return to Profitability: The annual ISO study provides an authoritative snapshot of Turkish industry. Overall, the industrial sector's share in GNP increased to 25.6 percent in 2002 from 23 percent the previous two years, with the top 500 companies accounting for 53.9 percent of that total (13.2 percent of GNP). Sales of the top 500 companies grew 5.8 percent in real terms over 2001, with four-fifths of the companies registering a profit for the year, for an overall profit level of 5.7 percent (versus a 0.5 percent loss for the 500 companies in 2001). Sales and profits were largely export driven, with the 500 achieving a 17.3 percent increase in exports, for a total of 17.3 billion USD, 49.5 percent of the country's total exports. Other key factors in increasing profitability were decreasing labor costs (which took only 27 percent of sales revenue in 2002, versus 34 percent in 2001), lower interest rates, and decreasing rent. While the ratio of "other revenues" (interest earnings, real estate sales, and earnings from foreign currency exchange) over earnings from core operational activities was 114 percent in 2002 (it has been over 100 percent since 1999), it declined significantly from its level of 547 percent in 2001. The decline reflects a significant shift by firms back towards their core activities, a trend that should be reinforced in coming years if real interest rates and inflation continue to decline.

¶4. (U) Public vs. Private: The survey also provides a useful breakdown of state ownership in the industrial sector. While Turkey's two largest industrial concerns, the state refinery Tupras (slated for privatization this year) and Electricity Production Ltd. (EUAS) are state-owned (with sales quadruple and double the next largest companies, respectively), overall only 30 of the top 500 companies are in the state's hands. While private sector exports boomed in 2002, public sector industrial exports dropped from 1.2 billion USD to 972 million USD. Employment figures show that the IMF program is having an effect: the three largest employers on the list (TEKEL, Turkish Sugar Factories, and the Turkish Coal Mining Companies) are state owned, but overall employment in public sector companies fell 21.86 percent from 178,005 to 139,102. Private sector industrial employment rose 5 percent to 365,694. The increased efficiencies resulting from the cuts brought an impressive turnaround in profitability for public sector companies, from negative 6.1 percent to plus 8.3 percent. Private companies also saw increasing profitability, though the rise was more modest, with profitability reaching 5.1 percent in 2002 from 1.3 percent

in 2001.

¶5. (U) Winners: Koc Holding remains Turkey's largest private industrial group, with 19 companies in the top 500, and five in the top 10 private companies. Koc leads in all areas, including total sales, profits, exports, and employment. With group sales of 4.85 billion USD, the holding accounted for 9 percent of total sales and 11 percent of total private sector sales among the top 500. The country's second largest holding, the Sabanci group, has 15 companies in the top 500, but in a reflection of its increasing orientation towards financial services, has no companies in the top 10 private companies for either overall sales, exports, or profits.

¶6. (U) Words of Warning: In his public comments announcing the survey results, ISO President Tanil Kucuk noted that conditions are generally improving, but stressed that headline growth figures (7.8 percent in 2002 and 8.1 percent in this year's first quarter) are "too good to be true," and will not be sustainable until fundamental changes occur in the economy. He echoed points he has made frequently to us in recent meetings about the difficulties facing Turkish companies, including the unavailability of affordable credit, which requires companies to finance investments from their own resources, the high cost of energy and other inputs, and high tax and social security payments on wages, including particularly the increasing weight of indirect taxes (which now account for 70 percent of all tax revenues). Action is needed, he stressed, to expand Turkey's tax base and thereby reduce the size of the shadow economy and the unfair competition it represesents.

MUSIAD Survey

¶7. (U) Improving Morale: The MUSIAD survey, carried out in 27 provinces with participation by 1800 companies, showed a similar improvement in morale, while also highlighting the challenges on the horizon. 50 percent of the companies surveyed increased production in the first half of 2003, 54 percent experienced an increase in domestic sales, 58 percent saw an increase in exports, and 45 percent increased their workforce. Profitability presented a more mixed picture, however, with 36 percent seeing increased profits, 29 percent seeing no change, and 35 percent suffering a drop in profitability. Expectations for the second half of the year were more positive, with predictions for increases outpacing first half results for sales (61 percent), exports (76 percent) and employment (57 percent). One-third of respondents noted that they operate at 70-80 percent of capacity, with 22 percent utilizing 60-70 percent, and another 22 percent utilizing less than half.

¶8. (U) Continuing Challenges: The MUSIAD survey highlights the fact that even small companies are heavily dependent on exports, with 58 percent of respondents exporting 61-80 percent of their production, and 9 percent exporting virtually everything they produce. Exports continue despite the appreciating Turkish lira, but many respondents warned that the profit margin on exports is becoming dangerously low. The survey also highlighted the continuing financing problems facing Turkish industry, with general reluctance (and inability) to use outside funding sources forcing two-third's of respondents to utilize their own equity to continue their operations. Only 21 percent utilized bank loans.

¶9. (U) MUSIAD Chairman Ali Bayramoglu suggested that increasing growth and declining inflation show that the wounds of 2001 are gradually healing. He argued that business confidence in the government is increasing, but pressed for action to reduce the domestic borrowing requirement of the government and to bring Turkey's widening current account deficit under control. If action is not speedily taken on these issues, he warned, including through a "controlled flexible currency policy," Turkey faces a possible crisis in the fall.

¶10. (SBU) Comment: The MUSIAD and ISO studies confirm what we are hearing anecdotally from other contacts here in Istanbul: the real economy has improved over the past year and a half, but remains fragile, and sensitive to macroeconomic shocks. Most concur that headline growth figures exaggerate the extent of improvement in the economy, and that the important motor of domestic demand has only improved marginally over the past year. Given the critical problem of financing, which hampers almost all Turkish companies, most business groups remain strong backers of Turkey's economic reform

program, hoping that by reducing inflation and changing the country's risk profile real interest rates can be brought to a more business-friendly level. MUSIAD, long a strong critic of the program, remains the only significant exception to that rule. End Comment.
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